NFHA
National Fair Housing Alliance

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October 15, 2007

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
Via email: regs.comments@occ.treas.gov

Re: Docket ID OCC-2007-0013

The National Fair Housing Alliance (NFHA) commends the agencies for issuing the Proposed Illustrations of Consumer Information for Subprime Mortgage Lending. The proposed Illustrations recognize the on-going risks presented by subprime mortgages to homeowners and the economy. NFHA offers comments and specific revisions to the Illustrations to add clarity to the terminology and more adequately assist borrowers in understanding and evaluating the risks inherent in their mortgages.

The National Fair Housing Alliance, a consortium of over 100 private, non-profit fair housing organizations, state and local civil rights groups, and individuals, was founded in 1988 to lead the battle against housing discrimination. NFHA works to ensure equal housing opportunity for all people through leadership, education and outreach, membership services, public policy initiatives, advocacy, and enforcement. NFHA and its members are dedicated to assuring that communities have equal access to credit and related services.

NFHA strongly believes in the utility of illustrations so long as they provide realistic examples of the terms and consequences related to the particular loan being offered to the consumer by the institution. Providing consumers with very specific illustrations regarding the particular loan or loans being offered to them – **at a time no later than the date that the Good Faith Estimate is provided** – is an effective way of informing consumers about the loan product they are being offered. This can be accomplished by institutions inserting specific loan provisions into computer generated documents, thus posing no undue burden on the industry.

It is important to consider that many consumers do not understand the loan process, their loan terms or even the documents they sign at closing. The illustrations by themselves will be insufficient in insuring that consumers truly understand the material risks related to their loans. The Regulators will have to insure that not only are the Illustrations clear to consumers but that institutions provide them well in advance of the loan closing, that the illustrations are relevant to the consumer's circumstance and do not further confuse the consumer, and that the illustrations thoroughly explain the illustrations and provide meaningful and accurate responses to consumers' inquiries.

However, since the use of the proposed illustrations is entirely voluntary and institutions are free to expand, abbreviate, or otherwise tailor the information, NFHA urges the Regulators to include in its final illustrations examples of specific language or illustrations that should be prohibited or considered in contravention of the spirit and intent of the proposed illustrations. Specifically, NFHA notes that certain ARM disclosure documents currently in use by mortgage lenders illustrate the effect of an interest rate increase by giving examples based on a $10,000 principal balance. The use of an unrealistically low principal balance to illustrate the impact of a rate increase on a mortgage loan deceptively masks the true impact of a payment increase while purporting to be a disclosure for the benefit of the consumer.

Overall, the illustrations, as proposed, require revisions if institutions are to use them to implement the Consumer Protection Principles. NFHA recommends that lenders offer illustrations based on the actual loan product or product choices that it will offer to the specific individual loan applicant, rather than providing generic information without dollar figures. For example, the heading "Important Facts About **Your** Adjustable Rate Mortgage" (emphasis added) would be confusing to a consumer unless an illustration with this title was prepared for the specific ARM product the consumer was considering. Also, the statement "Your monthly payment will not include an amount to cover taxes and insurance" is insufficient to fully apprise the consumer of the cost of the particular loan that is being offered.

Finally, NFHA offers a one page "Adjustable Rate Mortgage Information Sheet" to be completed by the mortgage broker or lender and to accompany NFHA's suggested revisions to the illustrations. This will further assist the borrower in understanding the variable nature of interest rates in ARM products.

Also, note that new products are being developed daily as the subprime market continues to evolve. New and/or modified illustrations will need to be developed to adequately explain the new mix of products that will inevitably make their way into the marketplace.

In the section below, you will find NFHA's proposed changes. Our rationale for each suggested change is set apart with a double asterisks ** and language in italics.

Thank you for your attention to this matter.

Sincerely,

Shanna L Smith

Shanna L. Smith
President and CEO

Illustration 1

Important Facts About Your Adjustable Rate Mortgage

Whether you are buying a house or refinancing your mortgage, this information can help you decide if an adjustable rate mortgage (ARM) is right for you. ARMs can be complicated. **If you do not understand how ARMs work or you know that you cannot afford a higher monthly payment if the interest rate on your ARM increases, you should not sign any loan contracts, and you might want to consider a fixed rate loan instead. Do not assume that you will be able to refinance your ARM to a lower rate if you cannot afford the future payment increases.**

With an ARM, the interest rate on your loan is not fixed. Instead, the interest rate changes over time according to a formula – typically, a base interest rate (index) plus a certain percent (margin) (for example, the index would be referred to as the LIBOR Rate or the Prime Rate plus 3 percent). So, if the index (base interest rate) increases, your interest rate and monthly payment will also increase.

***The LIBOR is a common index used in subprime ARMs. The addition of the reference to the LIBOR would keep the illustration consistent with the terminology in the actual promissory note.*

Carefully read the information below about important features of ARM loans.

▶ **Your loan will have a reduced initial interest rate.**

Most ARMs have a reduced interest rate (start rate or initial rate) for a short period of time – for example, the first two years of the loan. This initial introductory_interest rate is less than the index plus margin rate. This means that your interest rate and monthly payments will be lower than normal for the first two years. However, your interest rate and monthly payment may increase significantly when that period is over – even if market rates stay the same. And, your interest rate and monthly payment will increase even more if market rates rise. In a subprime ARM, your interest rate will never be lower than the initial rate, even if market rates go down.

***Prime borrowers often benefit from a reduced interest rate when the index goes down. Subprime borrowers should be informed at the outset of their consideration of the ARM product that the start rate or initial rate is the lowest rate possible.*

▶ **Your monthly payment will not include an amount to cover taxes and insurance.**

In some mortgages, your monthly payment includes both principal and interest and an amount to cover real estate taxes and homeowner's insurance (also referred to as "escrow" for taxes and insurance) – and your lender pays your taxes and insurance out of these escrow funds. In other mortgages, your monthly payment covers only principal and interest, and you are responsible for paying real estate taxes and insurance premiums when the bills arrive. When you are comparing mortgages, or deciding whether you can afford a mortgage, you need to know whether or not the monthly payment includes an amount to cover estimated taxes and insurance.

▶ **You will be required to pay a prepayment penalty if you pay off your loan [delete "more than 60 days before the initial interest rate is adjusted"] before the expiration of the prepayment penalty period. The amount of the penalty will be a percentage of the outstanding balance of the loan and will be added to your pay-off amount.**

Some ARMS require you to pay a large prepayment penalty if you sell your home or refinance during the first few years of the loan. A prepayment penalty can make it difficult, or very expensive, to sell your home or refinance – which you may think you need to do if your interest rate, and therefore your payment, is about to increase significantly or if your circumstances change and you must sell your home before the prepayment period expires. If you obtain a loan with a prepayment penalty, you should have a compensating reduction in your interest rate.

** *The reference to the 60 day window implies that the borrower could rely on this time period to avoid a prepayment penalty. However, since the Guidance recommending the 60 day window is not mandatory, lenders should not refer to the 60 day time period unless they are bound to honor it, as evidenced in the promissory note.*

** *Prepayment penalties are almost nonexistent in the prime market. While NFHA believes that prepayment penalties should be banned in the subprime market, NFHA offers the additional language above if prepayment penalties continue to be permitted. Lenders state that prepayment penalties are accompanied by a reduced interest rate and that the consumer chooses a prepayment penalty in exchange for the reduced rate. The fact that the consumer has a choice should be expressly stated along with the interest rate offered with and without the prepayment penalty so that the consumer can accept or decline the penalty.*

▶ **Your loan will have a balloon payment.**

Most mortgages are set up so that you pay off the loan gradually by the monthly payments that you make over the loan term (for example, 30 years). Some ARMs, however, are set up with "balloon payments" – you make a certain number of monthly payments but these payments are less than the amount required to pay the loan in full by the end of the loan term. For example, with a 15 year balloon mortgage, you will make the same payments for 14 years and 11 months. For the final payment at the end of the 15th year, you will owe one large final payment known as the "balloon payment" which will be the entire remaining balance of the loan. The balloon payment will be thousands of dollars. When the balloon payment is due you would need to refinance your loan if you are unable to make the balloon payment, or sell your home if you cannot refinance the loan.

*** NFHA believes that the phrase "you make the same monthly payments that you would for a 30-year loan" is not an accurate statement of the payments required under balloon mortgages.*

▶ **Your loan will have a higher interest rate, costs and fees because of reduced documentation.**

"Reduced documentation" or "stated income" loans usually have higher interest rates or other costs compared to "full documentation" loans which are available if you document your income, assets, and liabilities. These higher costs can be substantial. If you can provide proof of your income and assets, it is not necessary to obtain a reduced documentation loan.

*** Reduced documentation loans are marketed to consumers as a "convenience" and the costs to the consumer in exchange for this product are not explained. It is simply unnecessary for a salaried worker, or for anyone who can provide documentation to even be offered a higher cost loan. The cost of the loan far outweighs any "convenience" to the borrower.*

*** ARM information would be incomplete if Interest Only Loans and Payment Option ARMs were omitted from information provided by an institution, especially if these products are offered to the consumer. Proposed information is below.*

▶ **You have an Interest Only Loan.** An Interest Only or IO loan means that you will only be paying the interest on your mortgage note for a certain period of time. For example, for the first five years, your payment will be fixed. While you will be paying the interest you owe, you will not be paying any money toward your principal. After the interest only period ends, you will be required to pay both principal and interest. You will have fewer years to pay off the principal on your loan. For example, if you have an interest only period of 5 years and a loan term of 30 years, instead of paying your principal and interest over 30 years, you will only be paying interest for the first 5 years and interest and principal for the remaining 25 years of the loan. This means that your monthly payment will jump significantly to cover all the costs of the principal and interest.

▶ **You have a Payment Option ARM.** A Payment Option ARM means that you can choose the payment you want to make based on monthly payment options provided by your lender. However, you should keep in mind that if you make the minimum payment, you are paying less than the interest due, your loan balance will increase and you will end up owing more than the initial amount that you borrowed. This is known as negative amortization and you are increasing your loan balance every time you make only a minimum payment. You cannot make minimum payments indefinitely. When your loan balance increases to a certain amount (as stated in your particular loan), your lender will notify you that you must start making a payment that includes principal and interest. Depending on how high your loan balance has risen, your monthly payments could increase significantly.

- **You may qualify for a fixed rate or lower cost loan.** You should keep in mind that, even if you have a lower credit score, you may still qualify for a fixed rate or lower cost loan. However, your current loan officer or mortgage broker may not be able to offer you a fixed rate loan or a loan below a certain interest rate. To find out if you qualify for a better rate, you should shop around at several lending institutions within a short timeframe.

WARNING: DO NOT OBTAIN THIS LOAN IF YOU ARE COUNTING ON BEING ABLE TO REFINANCE YOUR LOAN WITHIN SEVERAL YEARS BECAUSE:

- **Refinancing is costly.** Every time you refinance, you incur closing costs of thousands of dollars.

- **Your equity may be depleted. This may make it more difficult for you to refinance.** When you roll closing costs into your loan, you are depleting the equity that you have built up in your home.

- **Your credit score may not improve enough to warrant a lower interest rate.** Your credit score is based on a number of complicated measurements including how timely you make your credit payments, how much available credit you have, how long your credit lines have been open, among other things. Your credit score may be negatively impacted as well if you get a Payment Option ARM and do not make full payments.

- **Your property value may go down.** Property values are based on market fluctuations. No one can predict what your property's value will be next year or five years from now. If your property value goes down, you may end up owing more money than your house is worth. This will negatively impact your ability to refinance your loan or sell your house if you cannot refinance.

- **No one can predict what interest rates will be in the future.** If you have to refinance, you cannot assume that interest rates will be better in the future or that underwriting standards will remain the same. Lenders change their underwriting guidelines, products and credit standards for a number of reasons. The future is never certain. If you are taking an adjustable rate mortgage and you are relying on refinancing when your rate adjusts, keep in mind that you may not be able to refinance.

NFHA offers the following itemized chart to be provided to the consumer to accompany the illustrations:

Specific terms of the ARM loan you are considering are explained below.

Loan amount requested: $ _____. Loan term: _____ years.

Is there a prepayment penalty?

_ _No prepayment penalty.
_ _Yes. I will pay a prepayment penalty if I sell my house or refinance this mortgage within___ months or___ years after I sign the loan documents.

In exchange for accepting the prepayment penalty, my interest rate is reduced from ___% to ___%.

With estimated closing costs and fees, I will have to borrow $ ______.

The Annual Percentage Rate (APR) is _____%.

For the amount I have to borrow ($_____):

The initial interest rate of___% will be in effect for the first _____ (number of months or years).

$ ______ Monthly payment for principal and interest at this initial interest rate.
$ ______ Plus escrow for property taxes.
$ ______ Plus escrow for homeowner's insurance.
$ ______ **Total monthly payment for the first _____ (number of months or years).**

At the first time the interest rate can change or adjust, the interest rate could be as high as _ _%.

$_ _____ Highest amount I might pay for principal and interest at the first rate adjustment.
$ _ _____ Plus escrow for property taxes.
$ _ _____ Plus escrow for homeowner's insurance.
$ _ _____ **Total monthly payment for the next _____ (number of months or years).**

After the first interest rate change date, my interest rate could change every ____ (number of months or years). At each interest rate change, my interest rate could go up or down by no more than ____%.

Even if interest rates go down, my interest rate will never be lower than ____% anytime during this loan.

The highest my interest rate could go up to is _____%.
Mortgage Broker or Loan Officer's Name: ______________________________
(Printed)

Company Name: ______________________________

Address: ______________________________

Telephone ______________________________

______________________ ______________ ______________________
Signature **Date** **Title**

Illustration 2

*** NFHA believes that the Sample Mortgage Comparison should include specific figures for the particular loan being considered or offered. If institutions choose to illustrate a generic table i.e., "Not actual loans available", the Proposed Illustrations should prohibit lenders from using unrealistically low mortgage figures when providing examples of possible payment increases on ARMS.*

NFHA offers the following Sample Mortgage Comparison to reflect the actual mortgage loan being offered.

SAMPLE MORTGAGE COMPARISON *of the adjustable rate loan you are considering*		
Loan Amount $200,000 – 30 Year Term – ***Possible Interest Rates Based on this ARM***		
	Fixed Rate Mortgage 7.5%	**Reduced Initial Rate "2/28" ARM** 7% for two years, then adjusting to variable rate; 10% maximum rate in Year 3; 11.5% maximum rate in Year 4; 13% maximum rate in Years 5-30
	REQUIRED MONTHLY PAYMENTS (includes $200 per month for real estate tax and insurance escrow)	
Years 1-2	**$1,598**	**$1,531**
Year 3 – ***even* if *market* interest rates *do not increase***	**$1,598** ***No increase in payment***	**$1,939** ***Monthly payment has increased by $408***
Year 4 – ***even* if *market* interest rates *do not increase***	**$1,589** ***No increase in payment***	**$2,152** ***Monthly payment has increased by an additional $213***
Year 4 – if *market interest* rates rise 2%	**$1,589** ***No increase in payment***	**$2,370** ***Monthly payment has increased by additional $218***

Your monthly payments could increase even further if your taxes and insurance also increase.

If you refinance after 2 years to avoid the significant monthly payment increase starting in Year 3, the money you appeared to have saved in the first two years will be entirely lost due to the closing costs of a refinance and you will have to borrow more against the equity in your home to cover the closing costs.